ASSOCIATION OF CONSULTING ACTUARIES

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Code12consultation@tpr.gov.uk

Napier House
Trafalgar Place
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Dear Sir / Madam

Consultation on the revised Code of Practice 12

I am writing on behalf of the Association of Consulting Actuaries in response to the consultation on the above Code of Practice. Our thoughts are set out in the Appendix to this letter.

We welcome the positioning in your press release that the new tests should not significantly shift your current approach in this area. However, these new tests, especially as they found their way into the then Bill with limited discussion, have caused considerable concern and so we think it important that this Code and its related guidance makes clear that most normal corporate activities will not be drawn into scope.

In addition, this Code and guidance are cross referenced from the draft criminal offences guidance which you consulted on recently – in particular the references to material detriment. In our response to that consultation we noted that this was helpful but that the Code/guidance needed to be tightened to reflect the more significant penalties and increased scope of these new powers. More clarity needs to be added on material detriment, from this perspective.

We hope that you find the contents of this letter of assistance. We would be happy to discuss them further if that is helpful. In that event, please contact me on 01372 733763 or at peter.williams@aon.com.

Yours faithfully

Peter Williams
Chairman, Pension Schemes Committee
On behalf of the Association of Consulting Actuaries Limited

APPENDIX

Code of Practice 12: Circumstances in relation to the material detriment test, the employer insolvency test and the employer resources test

Specific consultation questions

1. Is our overall approach in the draft code and code-related guidance consistent with the policy intent behind the changes introducing the two new alternative 'act' tests to the CN power?

No

We understand from you that the policy intent is to deliver tests that focus on the effect of an act of an employer, without having to look at whether this affects the prospect of scheme benefits being paid many years into the future. What is not clear from the consultation document is whether the policy intent is to capture more situations, or to capture the same situations for which the material detriment test was intended, but by using new tests that are easier to pass. We appreciate that TPR has commented that there is no intent to capture more situations, but this should also be made clear in the code and guidance.

Also, despite your stated objective in your press release ("*to explain the circumstances in which [you] will consider issuing a CN on the basis of the new tests*"), it seems that the four circumstances in paragraph 14 could give rise to a CN on both the current test and one or more of the new tests. You also do not distinguish between the new tests and the current test in the illustrative examples.

2. Is the code clear on what the tests are and the circumstances in which we will consider any of the tests to be met? If not, how could we make it clearer, without limiting the scope of the tests?

No – in relation to the tests. Yes – in relation to the circumstances

<u>The tests</u>

In relation to the tests the Code does no more than set out the wording in the legislation. There is no exploration of the meaning of *"materially detrimental to the likelihood of the accrued scheme benefits being received"*, *"materially reduced the amount of the debt likely to be recovered by the scheme"* or *"a material reduction relative to the estimated section 75 debt in relation to the scheme"*.

We think it is essential to include some analysis of the meaning of the first term given that one of the new criminal offences relies on this definition. The comments on material detriment in this Code and guidance are cross referenced from the draft criminal offences guidance which you consulted on recently. In our response to that consultation we noted that this was helpful but that the Code/guidance needed to be tightened to reflect the more significant penalties and increased scope of these new powers. More clarity needs to be added on material detriment, from this perspective

It is also important to gain some insight into the meaning of the second two terms as there will be many quite normal corporate situations that satisfy, on a snapshot basis, the first leg of the employer insolvency test (any reduction in value of assets) or the first leg of the employer resources test (any reduction in value of resources), but are presumably not intended to be brought into scope of a contribution notice.

In relation to the employer resources test we don't understand how the material reduction relative to the estimated section 75 debt is to be measured. For example, if a scheme has a modest section 75 debt there could easily be situations where the reduction in employer resources is material relative to the section 75 debt, but it is of little consequence as the debt is modest and it continues to be well-covered by employer resources. And yet, it would appear that the employer resources test will have been met. On the other hand, if a scheme has a substantial section 75 debt and limited employer resources, a substantial reduction in employer resources may not pass the test because the reduction is not material in relation to the section 75 debt. It would be useful if you could explain how you intend to interpret this aspect of the employer resources test.

We note that the Department for Work and Pensions has now settled the employer resources regulations with the normalised profit before tax metric that was consulted on. We also note that in its response, the DWP says that where the employer resources test is met, the separate statutory test for reasonableness obliges you to take account of all relevant factors before imposing a Contribution Notice – and this may include a broader assessment of the employer's strength than that provided by the test. We think that this thought should be woven into the soon to be settled Code. This broader assessment could well involve the use of the EBITDA (Earnings Before Interest Tax Depreciation and Amortisation) measure put forward by many respondents to the DWP's consultation, and which was acknowledged as a possible measure for the test.

<u>The circumstances</u>

The four circumstances set out in the Code are useful. We note that they are very different to the outdated circumstances set out in the currently published Code (issued in June 2009), with only one of the five circumstances listed there surviving into the proposed Code.

It was an insight to us that, with one exception, each circumstance could be covered by any of the three tests. This suggests to us that the need for the two new contribution notices is to make it easier for you to pass a test; not in order to tackle different circumstances.

In relation to the second proposed circumstance we think it should become more limited through saying that the weakening of the scheme's creditor position is, for example, 'significant'.

It would be helpful if the Code stated clearly that only these listed circumstances would be expected to result in any of the tests being met. This is particularly important in the context of material detriment given the anticipated cross referencing from your criminal offences guidance.

3. Are the examples provided in the code-related guidance useful in illustrating the circumstances in which we might consider the new 'act' tests to be met? Are there any other examples you would consider helpful?

Yes.

The examples illustrating where the tests would be <u>unlikely to be met</u> are useful, but we would like to see more of them, in order to provide comfort that normal corporate activity, with minor and possibly temporary potential detriment to the scheme, should not be drawn into scope. You will be aware that these new tests have caused a great deal of concern given their potentially wide application. The code-related guidance is your opportunity to assuage those fears.

In particular, we would like to see "payment of dividends to parent company", in the present code-related guidance being retained. We think it important to give comfort that where a company is trading profitably, the scheme is in deficit but this is being tackled by an appropriate recovery plan, that a routine annual dividend payment, paid in the normal course of business, falls outside the tests.

The examples illustrating where the tests would likely be met are useful. We suggest that a number of their titles should be adjusted so that it is clear that only those situations where sponsor support is **significantly** reduced, or the scheme's creditor position is **substantially** weakened are in scope. It would also be useful to explain for each of them which of the three tests could be applicable.

We would also like to see some examples that speak to where covenant strength is effectively provided by a guarantor and a weakening in the guarantor potentially invokes the employer insolvency test.

We also suggest that you consider including some of the less obvious situations – for example where the sponsoring employer has been taken over by private equity investors, which through levying high management fees reduce the employer's normalised profit before tax and so potentially triggers the employer resources test.

4. Do you have any other feedback?

We would like to see an early consultation on the promised revision to the clearance guidance. It is most important that this guidance is refreshed in time for the 1 October 2021 switch on of the new CN regime.

Disclaimer

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